



Appendix E-1

KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' Report

The Board of Directors
National Dairy Promotion and Research Board:

We have audited the accompanying balance sheets of National Dairy Promotion and Research Board (NDB) as of December 31, 2004 and 2003, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of NDB's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of NDB's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of National Dairy Promotion and Research Board as of December 31, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our 2004 audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in the schedule of reconciliation of operations budget is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2004 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

April 8, 2005

NATIONAL DAIRY PROMOTION AND RESEARCH BOARD

Balance Sheets

December 31, 2004 and 2003

Assets	2004	2003
Cash and cash equivalents (note 3)	\$ 4,544,245	5,691,663
Assessments receivable, net (note 4)	7,588,476	7,668,879
Accrued interest receivable	184	91
Fixed assets (net of accumulated depreciation of \$126,730 and \$117,809 in 2004 and 2003, respectively)	11,186	20,107
	<u>\$ 12,144,091</u>	<u>13,380,740</u>
Liabilities and Net Assets		
Accounts payable:		
Related party – DMI	\$ 5,883,443	7,986,785
Other	236,859	138,784
Accrued expenses and other liabilities	134,337	331,199
Total liabilities	6,254,639	8,456,768
Commitments (note 5)		
Net assets – unrestricted	5,889,452	4,923,972
Total liabilities and net assets	<u>\$ 12,144,091</u>	<u>13,380,740</u>

See accompanying notes to financial statements.

NATIONAL DAIRY PROMOTION AND RESEARCH BOARD

Statements of Activities

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Revenue:		
Assessments	\$ 85,716,090	86,148,864
Interest income	28,759	42,161
Total revenue	<u>85,744,849</u>	<u>86,191,025</u>
Expenses:		
Program:		
Domestic marketing group	60,491,075	60,710,527
Research and evaluation group	3,081,654	4,952,087
Communications/member relations group	11,595,023	13,007,120
Export group	5,482,500	5,251,770
United States Department of Agriculture	659,305	554,121
Total program	<u>81,309,557</u>	<u>84,475,625</u>
General and administrative:		
DMI general and administrative	2,972,207	2,632,108
General and administrative	497,605	436,292
Total general and administrative	<u>3,469,812</u>	<u>3,068,400</u>
Total expenses	<u>84,779,369</u>	<u>87,544,025</u>
Increase (decrease) in net assets	965,480	(1,353,000)
Net assets at beginning of year	<u>4,923,972</u>	<u>6,276,972</u>
Net assets at end of year	<u>\$ 5,889,452</u>	<u>4,923,972</u>

See accompanying notes to financial statements.

NATIONAL DAIRY PROMOTION AND RESEARCH BOARD

Statements of Cash Flows

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ 965,480	(1,353,000)
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities:		
Depreciation and amortization	8,921	8,921
Changes in assets and liabilities:		
Assessments receivable	80,403	401,711
Accrued interest receivable	(93)	1
Accounts payable	(2,005,267)	(1,833,870)
Accrued expenses and other liabilities	(196,862)	(218,782)
Net cash used in operating activities	<u>(1,147,418)</u>	<u>(2,995,019)</u>
Net decrease in cash and cash equivalents	(1,147,418)	(2,995,019)
Cash and cash equivalents at beginning of year	<u>5,691,663</u>	<u>8,686,682</u>
Cash and cash equivalents at end of year	<u>\$ 4,544,245</u>	<u>5,691,663</u>

See accompanying notes to financial statements.



**NATIONAL DAIRY PROMOTION
AND RESEARCH BOARD**

Notes to Financial Statements

December 31, 2004 and 2003

(1) Organization

The National Dairy Promotion and Research Board (NDB) was established on May 1, 1984, pursuant to The Dairy and Tobacco Adjustment Act of 1983 (Public Law 98-180), as part of a comprehensive strategy to reduce milk surplus supplies in the United States (U.S.) and increase human consumption of U.S.-produced fluid milk and other dairy products. The purpose of NDB is to establish a coordinated program of promotion and research designed to strengthen the U.S. dairy industry's position in the marketplace and to maintain and expand domestic and international markets' usage of U.S.-produced fluid milk and other dairy products.

The United States Department of Agriculture (USDA) approved a joint venture between NDB and the United Dairy Industry Association (UDIA) to form Dairy Management Inc. (DMI) effective January 1, 1995. The purpose of DMI, a related organization, is to promote greater coordination, efficiency, and effectiveness and avoid incompatibility and duplication in the marketing programs and projects undertaken by NDB and UDIA. NDB and UDIA will jointly plan, develop, and implement their various marketing programs and activities through DMI, subject to the approval of the USDA.

NDB funds DMI on a cost reimbursement basis. Core costs, which include staff salaries and benefits, travel, Board of Directors, and office operating expenses are primarily funded by NDB, with UDIA funding one-half of Board of Directors and executive office costs. Marketing program costs, which include expenses associated with implementing the marketing programs of NDB and UDIA, are funded by NDB and UDIA based on the annual Unified Marketing Plan budget. NDB has funded DMI core costs of \$15,481,616 and \$14,213,094 and program costs of \$68,140,843 and \$72,340,518, for activity related to the years ended December 31, 2004 and 2003, respectively.

The U.S. Dairy Export Council (USDEC) is a related organization that was founded by the boards of both NDB and UDIA and began operations effective January 1, 1996. The purpose of USDEC is to improve the marketing conditions for the U.S. dairy industry with respect to the export of U.S. dairy products by promoting the acceptability, consumption, and purchase of U.S. dairy products in international markets. For the years ended December 31, 2004 and 2003, NDB reimbursed DMI \$5,482,500 and \$5,251,770, respectively, for USDEC's operations.

(2) Summary of Significant Accounting Policies

The financial statements of NDB have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. To facilitate the understanding of information included in the financial statements, summarized below are the more significant accounting policies.

(a) Cash Equivalents

NDB considers debt investment instruments with an original maturity of three months or less to be cash equivalents.

(Continued)

**NATIONAL DAIRY PROMOTION
AND RESEARCH BOARD**

Notes to Financial Statements

December 31, 2004 and 2003

(b) Assessments

Assessment revenue is generated by a mandatory assessment of 15 cents per hundredweight on all milk produced and marketed in the contiguous United States. Milk producers can direct up to 10 cents per hundredweight to USDA qualified state and regional generic dairy promotion organizations. For the years ended December 31, 2004 and 2003, the net NDB assessment was approximately 5.07 and 5.11 cents per hundredweight of milk marketed, respectively. Assessment revenue is recognized in the month in which milk is marketed.

(c) Fixed Assets

Fixed assets consist of computer equipment and software and are recorded at cost. Depreciation and amortization are provided in amounts sufficient to charge the cost of depreciable assets to operations over estimated service lives of five years using the straight-line method.

(d) Net Assets

All net assets of the NDB at December 31, 2004 and 2003 are unrestricted.

(e) Contract and Grant Expense

Expenses related to contracts are recognized as incurred. Grants for research projects typically require periodic reporting of project status and payments. Such payments are expensed as progress is achieved. In addition, a portion of the fund balance is designated for future payments under existing contracts and grants (see note 5).

(f) Income Taxes

NDB has received a determination letter from the Internal Revenue Service indicating that it is exempt from Federal and state income taxes on related income under 501(c)(3) of the Internal Revenue Code. There was no unrelated business taxable income for the years ended December 31, 2004 and 2003; therefore, no provision for income taxes has been reflected in the accompanying financial statements related to activities of NDB.

(g) Use of Estimates

Management of NDB has made certain estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

(h) Employee Costs

NDB's operations are staffed by DMI employees, who receive vacation, retirement, health, and other benefits provided by DMI.

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(Continued)

**NATIONAL DAIRY PROMOTION
AND RESEARCH BOARD**

Notes to Financial Statements

December 31, 2004 and 2003

(3) Cash and Cash Equivalents

Cash and cash equivalents consist of the following as of December 31:

	<u>2004</u>	<u>2003</u>
Operating cash in banks and on hand	\$ 305,034	162,185
Federal agency discounted securities	4,239,211	5,529,478
	<u>\$ 4,544,245</u>	<u>5,691,663</u>

(4) Assessments Receivable

Assessments receivable are recorded at the estimated net amounts to be received based on the amount of milk marketed and the average payment per hundredweight. In accordance with Public Law 98-180, NDB forwards unpaid assessments to the USDA for collection and other legal proceedings. As of December 31, 2004 and 2003, approximately \$101,000 and \$80,000, respectively, of cumulative unpaid assessments were at USDA pending further action. Such amounts are not included in assessments receivable as of December 31, 2004 and 2003, and will not be recorded as revenue until such amounts are ultimately received. Civil penalties exist for any persons who do not pay the assessment and/or file required milk marketed assessment reports with NDB.

(5) Net Assets

During 2004 and 2003, NDB's Board designated a portion of net assets for cash reserves. Total designations of net assets are as follows:

	<u>2004</u>	<u>2003</u>
Designated assets -- cash reserves	\$ 1,800,000	1,800,000
Undesignated net assets	4,089,452	3,123,972
Total net assets	<u>\$ 5,889,452</u>	<u>4,923,972</u>

(6) Transactions with the United States Department of Agriculture

NDB reimburses the USDA for the cost of administrative oversight and compliance audit activities. These reimbursements amounted to \$659,305 and \$554,121 for the years ended December 31, 2004 and 2003, respectively.

(Continued)

**NATIONAL DAIRY PROMOTION
AND RESEARCH BOARD**

Notes to Financial Statements

December 31, 2004 and 2003

(7) Litigation

NDB and the USDA are defendants in a lawsuit that claims the Dairy Promotion Program established by the Dairy Promotion Stabilization Act of 1983 (the Dairy Act) violates the First Amendment right to free speech and free association. The lawsuit seeks injunctive relief from the mandatory assessment fees paid to NDB on milk produced and marketed in the contiguous United States. These mandatory assessment fees are the primary revenue source for the National Dairy Board.

In 2003, a federal trial court in Pennsylvania found that the Dairy Promotion Program does not violate the claimants' right of free speech and association. However, on February 24, 2005, a three-judge panel of the U.S. Court of Appeals for the Third Circuit reversed this decision and found that the Dairy Promotion Program does violate the claimants' right of free speech and association rights by compelling them to subsidize speech with which they disagree. Currently, no injunction has been issued against the collection of assessments. If this decision is not reversed, however, the Dairy Promotion Program and NDB may be forced to make significant modifications to its current operations or possibly cease operations.

It has been represented to NDB that the USDA intends to vigorously defend against these claims. To that end, on April 9, 2004, the United States Justice Department (USJD) on behalf of NDB and the USDA filed a petition with the Third Circuit requesting that all of the judges of that court reconsider the February 24, 2004 decision of the three-judge panel. That petition argues that the panel's decision conflicts with applicable Supreme Court precedents, a key Third Circuit precedent, and with the decisions of two other Circuits (the Ninth and Sixth Circuits) that each upheld the constitutionality of the Dairy Act and rejected the precise argument that the third Circuit decided to accept. The Third Circuit rejected that petition. Therefore, the USJD on behalf of NDB and the USDA filed a request that the Supreme Court hear an appeal from the Third Circuit's decision, and to hold the case while the Supreme Court considers a similar challenge to the Beef Promotion Act (the LMA case). The LMA case was argued to the Supreme Court on December 8, 2004, and a decision is expected by June 2005. NDB expects that the Supreme Court will decide whether to consider the USJD appeal from the Third Circuit case once it decides the LMA case.

NDB believes there are very strong arguments in favor of the constitutionality of the Dairy Promotion Program. However, at this time, it is not possible to predict the outcome of the litigation or whether an injunction will be used against the collection of the assessments.



NATIONAL DAIRY PROMOTION AND RESEARCH BOARD

Schedule of Reconciliation of Operations Budget

Year ended December 31, 2004

	2004 Total expenses	2005 Commitments expensed in 2004	2004 Operations Budget Statement
Organizational group expenses:			
Domestic marketing group	\$ 60,491,075	(164,147)	60,326,928
Research and evaluation group	3,081,654	—	3,081,654
Communications/member relations group	11,595,023	—	11,595,023
Export group	5,482,500	—	5,482,500
DMI general and administrative	2,972,207	—	2,972,207
General and administrative	497,605	—	497,605
United States Department of Agriculture	659,305	—	659,305
Total organizational group expenses	\$ <u>84,779,369</u>	<u>(164,147)</u>	<u>84,615,222</u>

This schedule reconciles the total expenses from the Statement of Activities presented in accordance with accounting principles generally accepted in the United States of America to those reflected in the Operations Budget Statement which is used for management's internal purposes.

The 2005 commitments expensed in 2004 represent programs that management committed as part of the 2005 marketing plan.

See accompanying independent auditors' report.



KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Accountants' Report On Applying Agreed-upon Procedures

The Board of Directors
National Dairy Promotion and Research Board:

We have performed the procedures enumerated below, which were agreed to by the U.S. Department of Agriculture (USDA) and National Dairy Promotion and Research Board (NDB), solely to assist the specified parties in evaluating the entities' compliance with The Dairy and Tobacco Adjustment Act of 1983 (Act), the Dairy Promotion and Research Order (Order), and the Agricultural Marketing Services Directive (Directive) entitled *Investments of Public Funds* as of and for the year ended December 31, 2004. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representations regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings were as follows:

- (a) We obtained NDB's budget for the year ended December 31, 2004 and sighted the signature of the Secretary of the USDA.
- (b) We selected four investment purchase transactions from calendar year 2004, compared and agreed them against their respective brokers' advices, and noted the following:
 - The investments were in either U.S. Government Securities or Federal Agency Securities.
 - The investments had maturity periods of one year or less;
 - The U.S. Government Securities and Federal Agency Securities were held in the name of NDB at the institution.
- (c) We obtained the 1998 investment files and sighted various broker's advices noting that the investment records have been maintained for six years.

We were not engaged to, and did not conduct an examination, the objective of which would be the expression of an opinion on compliance. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the USDA and NDB and is not intended to be and should not be used anyone other than these specified parties.

KPMG LLP

April 8, 2005





KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

April 8, 2005

The Board of Directors
National Dairy Promotion and Research Board
Rosemont, Illinois

Ladies and Gentlemen:

We have audited the financial statements of the National Dairy Promotion and Research Board for the year ended December 31, 2004, and have issued our report thereon dated April 8, 2005. In planning and performing our audit of the financial statements of the National Dairy Promotion and Research Board, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control.

The maintenance of adequate control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the organization.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

This report is intended solely for the information and use of the United States Department of Agriculture, the Board of Directors, management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

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SNYDER-COHN-COLLYER-HAMILTON & ASSOCIATES P.C.

Independent Auditor's Report

To the Board of Directors

— National Fluid Milk Processor

Promotion Board

Washington, D.C.

We have audited the accompanying balance sheet of the National Fluid Milk Processor Promotion Board as of December 31, 2004, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the National Fluid Milk Processor Promotion Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the National Fluid Milk Processor Promotion Board as of December 31, 2004, and the results of its operations, changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued reports dated March 7, 2005 on our consideration of the National Fluid Milk Processor Promotion Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants agreements and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Certified Public Accountants and Business Advisors

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INDEPENDENT MEMBER

BKR

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APPENDIX E



To the Board of Directors
National Fluid Milk Processor
Promotion Board
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Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supporting information included in the report for 2004 (Pages 11 through 16) is presented for purposes of additional analysis and is not a required part of the basic financial statements of the National Fluid Milk Processor Promotion Board. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.

Snyder, Cohn, Collyer, Hamilton & Associates, P.C.

March 7, 2005
Bethesda, Maryland

National Fluid Milk Processor Promotion Board

Balance Sheet

December 31, 2004

Assets

Current assets:

Cash and cash equivalents	\$ 5,060,177
Assessments receivable, net of allowance for uncollectible accounts of \$156,163	11,213,726
Interest receivable	5,647
Future year costs	14,789,906
Other receivables	<u>214,439</u>

Total assets \$ 31,883,895

Liabilities and net assets

Current liabilities:

Accounts payable	<u>\$ 19,323,592</u>
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Net assets:

Designated for contingencies	2,500,000
Undesignated	<u>10,060,303</u>

Total net assets 12,560,303

Total liabilities and net assets \$ 31,883,895

APPENDIX E

See Accompanying Notes

National Fluid Milk Processor Promotion Board
Statement of Revenues, Expenses and Changes in Net Assets

For the year ended December 31, 2004

Revenues:	
Assessments	\$ 105,728,118
Late payment charges	54,080
Interest income	251,939
Other	<u>3,707</u>
Total revenues	<u>106,037,844</u>
Expenses:	
Program expenses:	
Media	69,508,310
Promotions	9,690,118
Public relations	13,311,999
Strategic thinking	1,864,083
Research	2,010,342
Medical advisory panel	189,439
American Heart Association	240,000
Medical research	119,190
Program measurement	<u>233,816</u>
Total program expenses	<u>97,167,297</u>
Other expenses:	
California grant	10,174,576
Administrative	2,151,789
USDA oversight	318,050
USDA compliance audit	<u>112,765</u>
Total other expenses	<u>12,757,180</u>
Total expenses	<u>109,924,477</u>
Excess of expenses over revenues	(3,886,633)
Net assets - beginning	<u>16,446,936</u>
Net assets - ending	<u>\$ 12,560,303</u>

See Accompanying Notes

National Fluid Milk Processor Promotion Board

Statement of Cash Flows

For the year ended December 31, 2004

Cash flows from operating activities:

Excess of expenses over revenues	\$ (3,886,633)
Changes in assets and liabilities:	
Increase in assessments receivable	(243,249)
Decrease in interest receivable	2,105
Increase in future year costs	(14,789,906)
Decrease in other receivables	159,443
Increase in accounts payable	<u>13,019,791</u>

**Net cash used in operating activities and net decrease
in cash and cash equivalents** (5,738,449)

Cash and cash equivalents - beginning 11,398,626

Cash and cash equivalents - ending \$ 5,660,177

See Accompanying Notes

National Fluid Milk Processor Promotion Board

Notes to Financial Statements

December 31, 2004

Note 1: Summary of significant accounting policies:

The National Fluid Milk Processor Promotion Board (the Board) was established pursuant to the authority of the Fluid Milk Promotion Act (the Act) of 1990, Subtitle H of the Title XIX of the Food, Agriculture, Conservation and Trade Act of 1990. The purpose of the Board is to administer the provisions of the Fluid Milk Promotion Order (the Order) established pursuant to the Act which establishes an orderly procedure for the development, and the financing through an assessment, of a coordinated program of advertising, promotion, and education for fluid milk products.

The Act requires that a referendum be conducted among processors to determine if a majority favored implementing the fluid milk program. In the October 1993 initial referendum, the majority of processors voted to approve the implementation of the fluid milk program. A continuation referendum was held in February-March 1996. Of the processors voting in that referendum, the majority favored continuation of the fluid milk program. In November 1998, another continuation referendum was held at the request of the Board and processors voted to continue the fluid milk program as established by the Order. The Act and Order state that the United States Department of Agriculture (USDA) will hold future referenda upon the request of the Board, processors representing 10 percent or more of the volume of fluid milk products marketed by those processors voting in the last referendum, or when called by the U.S. Secretary of Agriculture. On March 30, 2004, a Notice of Review and Request was published in the Federal Register. The purpose of the Review was to determine whether the Order should continue without change. No comments were received and the Order will continue without change.

For financial reporting purposes, the Board is considered a quasi-governmental agency of the U.S. government. As such, it is exempt from income taxes under the Internal Revenue Code. The USDA and its affiliated agencies operate in an oversight capacity of the Board.

The financial statements of the Board are prepared in conformity with accounting principles generally accepted in the United States of America. To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

Assessments - Beginning August 1, 2002, assessments are generated from those processors marketing more than 3,000,000 pounds of fluid milk per month by a 20-cent per hundred weight assessment on fluid milk products processed and marketed commercially in consumer-type packages in the 48 contiguous United States and the District of Columbia. Prior to August 1, 2002, the minimum monthly assessments were generated from processors marketing more than 500,000 pounds of fluid milk per month. Assessment revenue is recognized in the month in which the fluid milk product is processed.

National Fluid Milk Processor Promotion Board

Notes to Financial Statements

December 31, 2004

Note 1: Summary of significant accounting policies: (continued)

Late payment charges are assessed, as provided under the Act, to processors who do not remit monthly assessments within 30 days following the month of assessment. The late payment charge is equal to .015% of unpaid assessments and accrues monthly. At no time does the Board stop accruing interest on these assessments. The Board's management has established a policy of reserving 50% of the late fee charges.

California grant - In accordance with the Act, the Board is required to provide a grant to a third party equal to 80% of the assessments collected from Regions 14 and 15 to implement a fluid milk promotion campaign. Disbursements under these provisions are recorded as "California Grant" in the accompanying financial statements

Cash equivalents - For purposes of the statement of cash flows, the Board considers investments with an original maturity of three months or less to be cash equivalents.

Future year costs - Future year costs represent costs incurred for 2005 budget year projects.

Assessments receivable - An allowance for uncollectible accounts has been established for those assessments which management has determined as uncollectible.

Use of estimates - The Board has made certain estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Advertising - In accordance with its mission, the Board has approved the development of direct and nondirect response advertising and promotional activities. All costs related to these activities are charged to expense as incurred.

Note 2: Cash and cash equivalents:

At December 31, 2004, the bank balance of the Board's cash deposits was entirely covered by federal depository insurance or was covered by collateral held by the Board's agent in the Board's name.

	<u>Carrying Value</u>
Cash deposits	\$2,826,260
Repurchase agreements	295,016
Investments	<u>2,538,901</u>
	<u>\$5,660,177</u>

APPENDIX E

National Fluid Milk Processor Promotion Board

Notes to Financial Statements

December 31, 2004

Note 2: Cash and cash equivalents: (continued)

At December 31, 2004, the repurchase agreements were secured as to principal plus accrued interest by U.S. government securities held in the respective banks' safekeeping account, in the Board's name, with the Federal Reserve Bank.

The Board is required to follow the Agricultural Marketing Service (AMS) investment policy. Accordingly, the Board is authorized to invest in securities consisting of obligations issued or fully insured or guaranteed by the U.S. or any U.S. government agency, including obligations of government-sponsored corporations, and must mature within one year or less from the date of purchase. At December 31, 2004, investments consist entirely of U.S. government agency obligations. Investments are carried at cost, which approximates fair value. The Board's investments are held by the counterparty's trust department or agent in the Board's name.

At December 31, 2004, investments consisted of the following:

	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Interest Rate</u>	<u>Carrying Amount</u>
U.S. Securities:				
FNMA discount note	11/17/04	02/16/05	2.22%	\$1,539,333
FNMA discount note	12/08/04	02/16/05	2.27	<u>999,568</u>
				<u>\$2,538,901</u>

At December 31, 2004, the Board was owed accrued interest of \$5,647.

Included in cash and cash equivalents is \$2,500,000 of Board designated cash reserves.

Note 3: Compliance matters:

In accordance with the Act and the Order, effective one year after the date of the establishment of the Board, the Board shall not spend in excess of 5% of the assessments collected for the administration of the Board. For the year ended December 31, 2004, the Board did not exceed this limitation.

National Fluid Milk Processor Promotion Board

Notes to Financial Statements

December 31, 2004

Note 4: Program administration:

The Board entered into an agreement with the International Dairy Foods Association (IDFA) to administer the fluid milk program. Under this agreement, IDFA engages outside organizations to develop programs for advertising, promotion, consumer education, and certain minority initiatives. The organizations are:

- Draft (began January 2004)
- Lowe & Partners Worldwide
- Flair Communication, Inc. (ended January 2004)
- Weber Shandwick Worldwide
- Siboney USA

Under this and related agreements, IDFA also directly provides program management, administrative support and employee benefits management services and leases office space to the Board. During the year ended December 31, 2004, the Board incurred approximately \$1,080,000 for directly provided services. At December 31, 2004, the Board owed IDFA \$408,835 for costs billed under these agreements.

Note 5: Commitments:

The Board entered into an agreement during fiscal year 2000 with Walt Disney World Hospitality & Recreation Corporation (WDWHRC), whereby the Board will pay WDWHRC \$1,800,000 each year for the next six years through 2006 in exchange for the sponsorship and certain promotional rights at the Sports Complex in order to cooperatively develop programs to promote fluid milk products at Walt Disney World Resort. In December 2003, both parties agreed to extend the term of the agreement for another three years through 2009 at the previously agreed rate of \$1,800,000 to be increased annually by the change in the Consumer Price Index.

In 2002, the Board entered into a five-year agreement with the American Heart Association. Under the agreement, the Board pays the American Heart Association \$120,000 annually from 2002 to 2007 for use of the logo on the processors' milk containers.

Note 6: Operating lease:

The Board incurred \$124,800 of rental expense during 2004, under a sublease with an automatic renewal option. For 2005, the annual lease payment under the contract will be \$129,000.

APPENDIX E

National Fluid Milk Processor Promotion Board

Notes to Financial Statements

December 31, 2004

Note 7: Transactions with the United States Department of Agriculture:

Under the provisions of the Act and the Order, the Board is required to pay the United States Department of Agriculture certain fees for oversight and evaluation costs. These costs were \$430,815 during 2004.

Note 8: Related party activity:

Accounting services for the Board are performed by Rubin, Kasnett & Associates, P.C. (RK&A); the cost of these services was \$299,859 during 2004. A principal of RK&A serves as the Chief Financial Officer of the Board and receives compensation for services performed.

The Board has entered into an employment agreement with its Chief Executive Officer (CEO). The agreement runs from January 1, 2004 to December 31, 2006 and provides for annual compensation, benefits and increases based upon the CEO's annual performance evaluation. The agreement also includes provisions that would require severance payments on early termination of the agreement.

Included with other receivables is \$137,688 due from IDFA which represents excess retirement plan fundings associated with the CEO's employment contract. This amount will be adjusted on an annual basis, and will be refunded to the Board upon the earlier of the CEO's termination or retirement.



SNYDER-COHN-COLLYER-HAMILTON & ASSOCIATES P.C.

Independent Auditor's Report on Supplementary Information

**To the Board of Directors
National Fluid Milk Processor
Promotion Board
Washington, D.C.**

Our report on our audit of the basic financial statements of the National Fluid Milk Processor Promotion Board for 2004 appears on page 1. We conducted our audit for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental information presented on pages 13 to 16 for the year ended December 31, 2004 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Snyder, Cohn, Collyer, Hamilton & Associates, P.C.

March 7, 2005
Bethesda, Maryland

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APPENDIX

National Fluid Milk Processor Promotion Board

**Schedule of Revenues and Expenses
Actual Compared to Budget
(Budget Basis)**

For the year ended December 31, 2004

	<u>Unexpended/ Amended Budget</u>	<u>Current Year Actual</u>	<u>Actual Over (Under) Budget</u>
Revenues:			
Assessments	\$ 103,200,000	\$ 105,728,118	\$ 2,528,118
Late payment charges	-	54,080	54,080
Interest income	-	251,939	251,939
Other	-	3,707	3,707
Carryover - prior years	<u>8,844,427</u>	<u>-</u>	<u>(8,844,427)</u>
Total revenues	<u>112,044,427</u>	<u>106,037,844</u>	<u>(6,006,583)</u>
Expenses:			
Program expenses:			
Program - current year	99,424,700	94,512,199	(4,912,501)
Program - prior years	<u>5,651,180</u>	<u>2,655,098</u>	<u>(2,996,082)</u>
Total program expenses	<u>105,075,880</u>	<u>97,167,297</u>	<u>(7,908,583)</u>
Other expenses:			
California grant	9,991,000	10,174,576	183,576
Administrative	2,248,727	2,151,789	(96,938)
USDA oversight	<u>380,000</u>	<u>430,815</u>	<u>50,815</u>
Total other expenses	<u>12,619,727</u>	<u>12,757,180</u>	<u>137,453</u>
Less encumbrances - prior years	<u>(5,651,180)</u>	<u>-</u>	<u>5,651,180</u>
Total expenses	<u>112,044,427</u>	<u>109,924,477</u>	<u>(2,119,950)</u>
Excess of expenses over revenues	<u>\$ -</u>	<u>\$ (3,886,633)</u>	<u>\$ (3,886,633)</u>

National Fluid Milk Processor Promotion Board

**Schedule of Program Expenses
Actual Compared to Budget
(Budget Basis)**

For the year ended December 31, 2004

	<u>Current Year Amended Budget</u>	<u>Expended Current Year Actual</u>	<u>Actual Over (Under) Budget</u>	<u>Prior Year Unexpended Budget</u>	<u>Expended Prior Year Actual</u>	<u>Actual Over (Under) Budget</u>	<u>Total Program Activity</u>
Expenses - 2004 budget							
Media	\$ 69,780,200	\$ 69,178,722	\$ (601,478)	\$ 567,456	\$ 329,588	\$ (237,868)	\$ 69,508,310
Promotions	11,735,000	9,099,914	(2,635,086)	1,734,385	590,204	(1,144,181)	9,690,118
Public relations	13,545,000	13,107,118	(437,882)	560,202	204,881	(355,321)	13,311,999
Strategic thinking	1,770,000	1,484,535	(285,465)	802,989	379,548	(423,441)	1,864,083
Research	1,965,000	1,273,608	(691,392)	1,177,333	736,734	(440,599)	2,010,342
Medical advisory panel	300,000	180,983	(119,017)	206,627	8,456	(198,171)	189,439
American Heart Association	-	-	-	360,000	240,000	(120,000)	240,000
Medical research	212,000	72,697	(139,303)	61,543	46,493	(15,050)	119,190
Program measurement	<u>117,500</u>	<u>114,622</u>	<u>(2,878)</u>	<u>180,645</u>	<u>119,194</u>	<u>(61,451)</u>	<u>233,816</u>
Total program expenses	<u>\$ 99,424,700</u>	<u>\$ 94,512,199</u>	<u>\$ (4,912,501)</u>	<u>\$ 5,651,180</u>	<u>\$ 2,655,098</u>	<u>\$ (2,996,082)</u>	<u>\$ 97,167,297</u>

National Fluid Milk Processor Promotion Board

**Schedule of Administrative Expenses
Actual Compared to Budget
(Budget Basis)**

For the year ended December 31, 2004

	<u>Current Year Amended Budget</u>	<u>Current Year Actual</u>	<u>Actual Over (Under) Budget</u>
Management contract	<u>\$ 375,000</u>	<u>\$ 345,488</u>	<u>\$ (29,512)</u>
Board meeting expenses	<u>350,000</u>	<u>290,625</u>	<u>(59,375)</u>
Staff salaries and benefits:			
Staff salaries and compensation	410,956	407,413	(3,543)
Staff retirement benefit	41,096	85,141	44,045
Payroll taxes	14,333	15,277	944
Health insurance	8,200	1,966	(6,234)
Life insurance	1,400	1,601	201
Disability insurance	1,500	771	(729)
Workers compensation	700	580	(120)
Other employee benefits	<u>2,200</u>	<u>2,160</u>	<u>(40)</u>
Total staff salaries and benefits	<u>480,385</u>	<u>514,909</u>	<u>34,524</u>
Finance and administration:			
Contract staff	140,000	140,000	-
Financial services	<u>300,000</u>	<u>299,859</u>	<u>(141)</u>
Total finance and administration	<u>440,000</u>	<u>439,859</u>	<u>(141)</u>
Other operating expenses:			
Legal	200,000	191,101	(8,899)
Audits	85,000	77,128	(7,872)
Office facilities	106,800	106,800	-
Support and maintenance	18,000	18,000	-
Staff travel	105,000	98,129	(6,871)
Telephone	5,000	1,147	(3,853)
Insurance	35,000	35,965	965
Postage and delivery	20,000	19,918	(82)
Unallocated administrative expense	<u>28,542</u>	<u>12,720</u>	<u>(15,822)</u>
Total other operating expenses	<u>603,342</u>	<u>560,908</u>	<u>(42,434)</u>
Total administrative expenses	<u>\$ 2,248,727</u>	<u>\$ 2,151,789</u>	<u>\$ (96,938)</u>

National Fluid Milk Processor Promotion Board

Schedule of Cash Receipts and Disbursements

For the year ended December 31, 2004

Cash receipts from operations:

Assessments	\$ 105,644,312
Late payment charges	54,080
Interest income	254,044
Other	<u>3,707</u>
Total revenues	105,956,143

Cash disbursements for operations (111,694,592)

Excess of disbursements over operating receipts (5,738,449)

Cash and cash equivalents - beginning 11,398,626

Cash and cash equivalents - ending \$ 5,660,177





SNYDER-COHN-COLLYER-HAMILTON & ASSOCIATES P.C.

**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial
Statements Performed in Accordance with
Government Auditing Standards**

**To the Board of Directors
National Fluid Milk Processor
Promotion Board
Washington, D.C.**

We have audited the financial statements of the National Fluid Milk Processor Promotion Board as of and for the year ended December 31, 2004, and have issued our report thereon dated March 7, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the National Fluid Milk Processor Promotion Board's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the National Fluid Milk Processor Promotion Board's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. We noted during the course of our audit one invoice and accompanying check paid to a vendor that did not have the dual signatures of approval.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

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To the Board of Directors
National Fluid Milk Processor
Promotion Board
Page two

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the National Fluid Milk Processor Promotion Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the National Fluid Milk Processor Promotion Board, management of the National Fluid Milk Processor Promotion Board, and the Dairy Programs, Promotion and Research Branch of the Agricultural Marketing Service Agency of the United States Department of Agriculture and is not intended to be and should not be used by anyone other than these specified parties.

Snyder, Cohn, Collyer, Hamilton & Associates, P.C.

March 7, 2005
Bethesda, Maryland

APPENDIX E



SNYDER-COHN-COLLYER-HAMILTON & ASSOCIATES P.C.

To the Board of Directors

National Fluid Milk Processor

Promotion Board

Washington, D.C.

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial statement audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the balance sheet of the National Fluid Milk Processor Promotion Board as of December 31, 2004, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended, and have issued our report thereon dated March 7, 2004. The financial statements were prepared in conformity with accounting principles generally accepted in the United States of America.

In connection with our audit, nothing came to our attention, insofar as it relates to accounting matters, that causes us to believe that the National Fluid Milk Processor Promotion Board:

- Failed to comply with laws and regulations applicable to the National Fluid Milk Processor Promotion Board;
- Failed to comply with Section 1160.212 of the Fluid Milk Promotion Order, relating to the use of assessment funds for the purpose of influencing governmental policy or action;
- Expended assessment funds for purposes other than those authorized by the Fluid Milk Promotion Act and the Fluid Milk Promotion Order;
- Expended or obligated assessment funds on any projects prior to the fiscal year in which those funds were authorized to be expended by the National Fluid Milk Processor Promotion Board's approved Budget and Marketing Plan;
- Did not adhere to the original or amended Budget and Marketing Plan for the year ended December 31, 2004;
- Did not obtain a written contract or agreement with any person or entity providing goods or services to the National Fluid Milk Processor Promotion Board;

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**To the Board of Directors
National Fluid Milk Processor
Promotion Board**
Page two

- Failed to comply with Section 1999H, paragraph (g) of the Fluid Milk Promotion Order, relating to the limitations on the types of investments which may be purchased by the National Fluid Milk Processor Promotion Board and the insurance or collateral that must be obtained for all National Fluid Milk Processor Promotion Board deposits and investments;
- Failed to comply with internal controls, except as described below;
- Failed to comply with disclosure requirements for lease commitments;
- Failed to comply with standards established requiring signed contracts, USDA approval letters (if necessary), contract term documentation within the file, and CFO's signature on the Board approval letter; or
- Failed to comply with the by-laws of the National Fluid Milk Processor Promotion Board or any other policy of the National Fluid Milk Processor Promotion Board, specifically as they relate to all financial matters, including time and attendance, and travel.

However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

During the course of our audit, we noted that one invoice and accompanying check paid to a vendor did not have the required signatures for approval of payment of both the chief executive officer and chief financial officer of the National Fluid Milk Processor Promotion Board.

This report is intended solely for the information and use of the National Fluid Milk Processor Promotion Board, management of the National Fluid Milk Processor Promotion Board, and the Dairy Programs, Promotion and Research Branch of the Agricultural Marketing Service Agency of the United States Department of Agriculture and is not intended to be and should not be used by anyone other than these specified parties.

Snyder, Cohn, Collyer, Hamilton & Associates, P.C.

March 7, 2005
Bethesda, Maryland

